

IRS Exempt Organizations Colleges and Universities Compliance Project Executive Summary of Interim Report (May 2010)

Background. This interim report results from an IRS compliance project focused on public and private nonprofit colleges and universities. The project was conducted as part of a larger effort to review the largest, most complex organizations in the tax-exempt sector. Colleges and universities represent one of the largest nonprofit segments in terms of revenue and asset size. Other recent projects include the nonprofit hospitals compliance project completed in February 2009.

This report is based on the responses to questionnaires the IRS sent in October 2008 to a sample of 400 public and private nonprofit colleges and universities. The questionnaire requested organizational and demographic information, as well as information about exempt and unrelated business activities, endowment funds, executive compensation and governance practices. Information generally was requested for the 2006 tax year.

The overall response rate was high (97%). The report includes the number of respondents to each question. Additional follow-up will be conducted in the case of the 13 organizations that did not respond at all to the questionnaire, as well as those organizations that did not respond completely.

The report reflects responses of 344 organizations (177 private and 167 public colleges and universities) across three groups based on student size:

- Small – fewer than 5,000 students
- Medium – 5,000 - 14,999 students
- Large – 15,000 or more students.

This report includes responses to most of the questions included in the questionnaire, but does not include responses to questions that require more analysis (including responses provided in narrative form) or the responses of eleven organizations with multiple campuses that elected to report on a system-wide basis. That information will be included in a final report.

Limitations of the Data. This report summarizes the data as it was reported in the responses to the questionnaires. The reported data has not been independently tested or verified. Data is only representative of the specific size categories (and only in cases in which the number of respondents was sufficient) and might not represent the public and private nonprofit college and university sector as a whole. Given changes in the economy and other circumstances since 2006, information provided for 2006 may not be representative of today's environment.

Summary of Preliminary Data.

The **organizational** section summarizes basic demographic data, such as student and faculty size, tuition rates, and related exempt and taxable organizations.

- A large number of organizations reported having related entities (45% of small, 82% of medium, and 96% of large organizations) – the most common type being related tax-exempt organizations.
- Many organizations (26% of small, 34% of medium, and 45% of large organizations) reported that they controlled at least 50% of one or more other entities. Many organizations that reported activities through controlled entities did not report receiving income from such activities or entities.

The **activity** section shows the number of organizations that reported they conducted up to 47 different types of activities listed in the questionnaire and whether they reported activities as exempt or taxable.

- Many organizations reported conducting a wide variety of activities that, depending on the facts and circumstances, might be exempt or taxable. Generally, a much larger percentage of organizations indicated that they conducted a particular activity than reported they included the activity on Form 990-T.
- Nearly half (48%) of small colleges and universities reported never filing a Form 990-T, compared with 29% for medium and 4% for large colleges and universities.

The **endowment fund** section addresses the types and size of endowments, as well as investments, investment management, use of funds and target spending rates.

- Nearly all of the organizations reported maintaining an endowment fund directly or through another entity.
 - 87% of small,
 - 97% of medium, and
 - 100% of large organizations.
- Organizations of all sizes reported investing endowment assets in a variety of investments; U.S. fixed income and U.S. equity investments predominated.
- Although the likelihood of participation in a particular type of investment varied by size level, for those colleges or universities that invested in a particular investment, the percentage of assets invested was fairly comparable across size categories.
- Consistent target and actual spending rates of approximately 5% of endowment assets were reported across all size categories.

The questionnaire included a number of questions related to **international activities**.

- The majority of colleges and universities reported making foreign investments through their endowments (e.g., 53% of small, 67% of medium, and 82% of large organizations reported investments in non-U.S. equities).
- Many colleges and universities reported using investment entities to make foreign investments of endowment funds.
 - 34% of small,
 - 47% of medium, and
 - 69% of large colleges and universities.
- At all size levels, some organizations reported using more than one type of entity to make foreign investments.
- Many organizations reported conducting educational programs outside of the United States.
 - 30% of small,
 - 54% of medium, and
 - 83% of large colleges and universities.

The **executive compensation** section includes compensation amounts of the highest paid employee and the highest paid executive, and summarizes reporting of certain compensation practices.

- The reported compensation of the highest paid officer, director, trustee, or key employee (ODTKE) was highest for large colleges and universities (average \$428,000, median \$361,000) and lowest for small colleges and universities (average \$202,000, median \$174,000).
- In most cases, the highest paid ODTKE was the chancellor/president.
- The reported compensation of the highest paid employee (other than an ODTKE) also was highest for large colleges and universities (average \$798,000, median \$352,000) and lowest for small colleges and universities (average \$145,000, median \$98,000).
- In small and medium organizations, the highest paid employee (other than an ODTKE) was most often a faculty member (approximately half of the organizations). In the case of large organizations, the highest paid employee (other than an ODTKE) was most often a sports coach (43% of organizations). A faculty member was the highest paid non-ODTKE employee in 34% of large organizations.
- More than half of the organizations in each size category reported using the rebuttable presumption procedure to establish executive compensation.
- Comparability data was less frequently relied on to establish compensation than the other rebuttable presumption factors (approval by independent governing body and contemporaneous documentation).
- In the majority of cases, organizations reported that none of their six highest paid ODTKEs were disqualified persons (persons in a position to exercise substantial influence over the affairs of the organization) immediately before entering into their compensation arrangements with the organization; thus, fixed payments fell outside of the section 4958

The **governance** section summarizes responses to governance-related questions included in the sections discussed above.

- A majority of organizations generally reported having governance policies in place in many areas, for example, written conflict of interest policies governing the ruling body and top management officials (ranging from 81% to 100%) and public availability of financial statements (ranging from 76% to 97%).
- The use of governance policies and practices in other areas, such as policies ensuring arm's length transactions with controlled entities, was less frequently reported.

Next Steps.

The IRS is currently conducting more than 30 examinations based on responses to the questionnaire. These examinations focus principally on executive compensation and unrelated business income issues and include review of controlled entity (IRC section 512(b)(13)) issues. In addition, data on governance policies and practices will be collected and reviewed. A summary of findings and information learned from the examinations will be included in a final report.

The IRS is conducting additional analysis of certain areas, particularly transactions between related organizations and with controlled entities, unrelated business activity losses and reporting, and the use of comparability data and the initial contract exception to set executive compensation. The IRS also is analyzing areas of possible reporting inconsistencies, such as respondents that reported controlled entities, but did not report income from such entities.

This additional analysis and the responses to questions not included in the interim report will be included in a final report. The final report also will include data weighted so that findings can be extrapolated to the sector as a whole, information on colleges and universities that responded on a system-wide basis, and information provided as narrative responses.